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TERMINATION OF SOCIAL SECURITY COVERAGE FOR EMPLOYEES OF STATE AND LOCAL GOVERNMENTS AND NONPROFIT GROUPS

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TERMINATION OF SOCIAL SECURITY COVERAGE FOR EMPLOYEES OF STATE AND LOCAL GOVERNMENTS AND NONPROFIT GROUPS

Introduction

The opportunity State and local governments and nonprofit organizations have to terminate social security coverage for their employees raises several important issues concerning the basis of mandatory coverage for all other workers, and the function of social security as the Nation's basic social insurance program. The focus of this discussion will be on the reasons these groups were covered on a voluntary basis, why termination of coverage has become an issue again in the last 2 years, and what the alternatives are for congressional response to the increasing number of requests for termination.

The paper includes three major sections: description of present law; a discussion of the major issues connected with voluntary termination; and a brief outline of possible legislative responses, including section 302 of H.R. 3207 which would eliminate the provision for voluntary termination. Appendix A includes a detailed legislative history of the current provisions for voluntary coverage; and Appendix B includes a description of termination activity to date, including numbers of employees and entities affected.

Present Law

State and local governments

Social security coverage for employees of the States and their political subdivisions is available only through agreements between the Secretary of Health and Human Services and the States. Under the agreements, each State decides which groups of employees (e.g., a specific county, city, teachers, etc.) will be covered, subject to provisions in the Federal law (affecting relatively few people) which mandate referendums of affected members of existing retirement systems in order to approve extension of coverage to their group. Under these provisions, about 70 percent—some 9.4 million out of the approximately 13.2 million State and local employees—are covered under social security. The major exceptions are the employees of the State of Alaska, the only State to withdraw from the system, and of Maine, Massachusetts, Nevada, and Ohio, which never chose to participate in the system.

The social security law permits termination of coverage for employees of State and local governments. The action to terminate coverage must be taken by the State, rather than by the employees of the State or local governments involved, and the termination applies to the whole group of employees covered under a specific agreement. The State must give 2 years' advance notice to the Secretary of its

desire to terminate social security coverage of the employees of a political subdivision, and such notice cannot be given until after the coverage has been in effect for at least 5 years. The law also provides that once coverage has been terminated for a group of employees it can never again be provided for that group. There is no requirement in the law that the employees involved be notified when a notice of termination is filed, or when coverage has actually been terminated. In addition, the Secretary may terminate an agreement if, after a hearing, he finds that a State either had "failed or is no longer legally able to comply with any provision" of the agreement.

Nonprofit groups

Work performed for a nonprofit religious, charitable, educational or other tax-exempt organization of the type described in section 501(c)(3) of the Internal Revenue Code is covered under social security if the organization files a certificate (or is presumed to have filed one under the "presumptive waiver" interpretation) with the Internal Revenue Service waiving its exemption from social security taxation. Work performed for other nonprofit organizations is covered compulsorily. It is estimated that about 80 to 90 percent of the roughly 5.3 million employees of 501(c)(3) nonprofit organizations are covered under social security; over 80 percent of employees in nonprofit organizations are involved in health or education-related activities.

Nonprofit organizations may terminate coverage for their employees upon giving 2 years' advance notice to the Secretary of the Treasury, but the notice may not be given until the coverage has been in effect for at least 8 years. Also, the Secretary may terminate coverage if the organization is no longer able to meet the requirements of section 501(c)(3) of the Code (in which case the employees are covered mandatorily), or if it is unable to pay the required social security contributions. As is the case for State and local governments, once coverage has been terminated for a nonprofit employer, the employer cannot again provide social security coverage for his employees. Also, nonprofit employers are under no legal constraint to notify employees that notice of termination has been filed with the Treasury Department, or to hold a referendum on the matter.

Major Issues

Historical background

The history of voluntary coverage of employees of State and local governments and of nonprofit groups is characterized by the gradual expansion of the opportunity to be covered by social security, first to those not covered by other retirement plans, then gradually to practically all groups of employees who wished to be covered. (A detailed discussion of the legislative history of voluntary coverage is contained in Appendix A.)

Three general principles were consistently applied in the 1950 amendments when coverage of State and local government and nonprofit groups was first enacted and in later amendments:

> First, coverage had to be voluntary, in order to extend coverage as quickly as possible in face of the political barriers posed by

employers concerned with tax treatment issues (i.e., perceived constitutional prohibitions against mandatory taxation of State and local governments, and the objections of religious nonprofit groups fearful of the possible precedent for taxing religious organizations);

Second, coverage had to be extended through application of the payroll tax to jobs, and thus through the employer, rather than to individual workers, since both the payment of the tax through withholding and the crediting of earnings to individual workers must initially be done by the employer as part of his payroll accounting process;

Third, groups of jobs, rather than individual jobs, were the unit of coverage ("coverage groups"), consistent with the social security system's basic principle of insuring all workers against the same set of risks, regardless of whether specific individuals get more from the program than others because they happen to incur the risks and the others do not. Group coverage thus minimizes the extent of optional participation in the system, and to the greatest extent possible prevents the preferences of individual current incumbents of jobs in a group from determining the participation in social security of all those who might occupy those jobs in the future. The limited exception to the principle of group coverage is the "divided retirement system" provision, which again was designed to allow those employees of a group who desired coverage, even though they already had an established retirement system, to choose to be covered through a referendum. Even in this case, however, all future employees in that group are covered automatically.

It seems clear, then, that the major factor underlying extension of coverage on an optional basis to certain groups was the desire of Congress to provide the opportunity for coverage under social security to these employees in a way that would avoid the perceived constitutional and political barriers to mandatory coverage. The provision for withdrawing from the system was seen as a necessary corollary to the extension of coverage on an optional basis, but was never an end in itself. (The termination provision receives little attention in the legislative histories of amendments since 1939, presumably because it was assumed that once covered, few groups would seek to terminate coverage.) However, the fact that a growing number of groups are choosing to exercise this option raises important questions about its consequences, both for those who withdraw and for those who do not have the option to withdraw.

The major questions can be phrased as follows:

(1) What is the basis in principle of mandatory coverage for most workers and optional coverage for others?

(2) What factors are encouraging groups to consider withdrawing from the system now?

(3) What are the specific advantages and disadvantages for employees when their coverage is terminated?

(4) What are the major policy considerations in continuing to allow voluntary termination of social security coverage?

Principles Underlying Mandatory Coverage

Social security was established as a means of insuring that workers, by virtue of having contributed to the system, would have a basic floor

of protection for themselves against inability to work by reason of age (and, later on, disability), and for their families in the event of the worker's death. The fundamental principle underlying compulsory coverage for most workers is that responsibility for paying for insurance against such risks should be borne by the society as a whole to the extent possible—the wider the range of risks, the broader must be the responsibility for supporting the cost of paying benefits. The social insurance concept implies that participation in the program both insures workers against specific risks (death, disability and retirement in old age) and engenders a joint responsibility that must be mandatory in order to prevent excessive financial burdens on those who might choose to participate if the system were voluntary.

Mandatory participation is the basis for two essential characteristics of social insurance. First, mandatory participation by workers paying the tax is necessary for a "pay-as-you-go" financing structure. Social security benefits are primarily financed not by past contributions but by current workers paying social security taxes—each working generation pays for the benefits being paid to the previous generation now retired. The future benefits of workers now paying taxes are assured not by the actual accrual of the dollars they pay into the system but by the continuing commitment of the society to financial support of the system through mandatory taxes paid by workers and employers.

Such a system is workable for the Nation's basic social insurance program, even though it would not be appropriate for a private plan, as long as participation (both entitlement to benefits and obligation to pay social security taxes) is mandatory for those covered by the system. Because most workers are covered regardless of how many times they change their jobs in a lifetime, they will pay social security contributions over their whole working careers. In this way, the system is assured a relatively stable and predictable source of financing, dependent only on economic variables, rather than on individual decisions about whether to participate. Mandatory participation for most or all workers in each generation, and from one generation to the next, insures the system's financing against adverse selection (e.g., by high wage workers who might believe that they could provide for their own retirement through private arrangements at a lower cost without social security).

Mandatory participation is also an implicit premise underlying the benefits provided through social insurance. During the 1930's it seemed evident that very large numbers of elderly citizens could neither provide for their own independent income when they could no longer work because of health or lack of employment, nor depend on their children to provide for them in time of economic depression. The social security system was established because working members of the society, despite their best efforts, cannot always predict what will happen over their working lifetimes, and cannot prepare adequately against all eventualities—early death, disability, the need to stop working after a full career, economic catastrophe wiping out past savings, etc. Thus, the system provides a minimum level of insurance against these eventualities by requiring contributions from all covered workers, even if none of the risks ever materialize for specific individuals, and even if individual workers think they will never incur any such risks or that they can provide for themselves if they do.

Requiring mandatory coverage for any worker creates the presumption that all workers will be covered mandatorily, unless compelling circumstances indicate an exemption is required because of some competing principle. It can be argued that it is inconsistent with the principle of equal treatment of all citizens for some individuals to be compelled to participate while others are granted a choice of noncompliance, unless such a distinction serves some higher purpose. The principle of broad, mandatory coverage for most workers was thus not applied to employees of State and local governments and nonprofit groups, for various reasons seen at the time to be important enough to outweigh the mandatory participation presumption.

Some State and local government employees, such as police, firefighters and teachers, who already had retirement system protection, were seen originally as needing social security coverage less urgently than the vast majority of workers in the private sector who were largely without any type of pension protection. It was also unclear whether the Federal Government could compulsorily tax State and local government entities. Certain tax-exempt nonprofit groups were also not covered mandatorily, primarily because the focus of coverage at the time was on industrial workers, and because religious and philanthropic groups feared that a mandatory social security tax would raise troublesome issues about their general tax-exempt status. In both cases, it seems clear that the legislators anticipated that those who were most in need of coverage would come into the system, and that voluntary participation was a relatively trouble-free way of extending that opportunity without inviting court challenges of various kinds.

The decision as to whether a group of jobs in State and local government or nonprofit employment should be covered under social security is in general left to the employer to make, not to the individual employees. Coverage is extended by levying the payroll tax on newly covered jobs, as part of the basic payroll tax/earnings credit process already in place for all other covered workers, and thus through the employer, rather than through the employees who happen to be holding those jobs at that moment. For most State and local government employees, no referendum is ever required to determine individual employees' preferences concerning entering the system; nonprofit employers are required to submit a list of concurring employees along with their waiver initiating coverage, but all future employees are covered without any option as long as the waiver is in effect. Because the option to terminate coverage was established only as a corollary to the option to initiate coverage, the employer was given primary responsibility for both decisions: fundamentally, participation in the system is voluntary for employers, not for employees.

Each worker's individual judgment as to whether he or she wants to continue to be covered by social security is thus important only as it might affect the decision of the employer, who is under no legal obligation to consult or even inform employees of intent to terminate. While the consequences of terminating coverage fall most heavily on employees, in terms of the impact on their benefits, the decision to terminate is basically an operating cost decision for the employer, who is compelled to consult employees in the matter only by the need to maintain good employee relations. While this compunction is very

powerful in many cases, it is nonetheless informal, with no legal sanction attached, and cannot guarantee uniform treatment for employees of all organizations that decide to terminate coverage.

Reasons for Recent Trend Toward Terminations

There are several reasons for the recent acceleration in terminations, related both to confidence in the social security system, and to short-term monetary gains for some employers and groups of employees. First, the rising costs of the social security program, particularly as a result of tax and wage base increases enacted in 1977, have prompted some employers (primarily nonprofit hospitals and some local governments) to look to withdrawal from social security as a way to reduce operating costs. These employers usually attempt to develop an independent pension plan for their employees that provides some basic benefits similar to social security at a lower cost to both employer and worker. (The difficulties of devising such plans to be comparable to social security are discussed in more detail below.)

Second, older employees can frequently increase their retirement income by ceasing to pay social security taxes (having already become fully (i.e., permanently) insured for retirement benefits) and investing those funds elsewhere. In many cases, specific employees within an organization are able to determine that they have become fully insured for a social security retirement benefit based on their earnings under the system up to that time. By leaving the system after paying in only for 10 or 15 years, these employees can realize a windfall, in terms of return on the amount of taxes they have paiw, as compared to workers who are covered by the system for their whole working careers.

In many cases, these groups of employees are active in supporting termination of coverage for the entire coverage group (e.g., county government or hospital) even though the effect of terminating coverage will not be the same for other current workers in the coverage group, such as younger workers, or women workers with only intermittent periods of coverage, or for workers joining the organization in the future. Older employees often also do not realize that terminating their coverage substantially before retirement will lower their final retirement benefits, and that they lose social security disability coverage 5 years after termination. (The windfall issue is discussed in more detail below.)

Finally, a general perception has developed, particularly on the part of younger workers, that the social security system will not be able to pay benefits when they reach retirement and that they would thus be better off withdrawing from the system and providing for their own retirement needs. While it can be shown that it is very difficult, if not impossible, to duplicate social security as it now exists either independently or through a private pension plan, a large number of younger workers now assume that the program, at least as currently structured, will no longer exist by the time they retire.

Although the social security system is part of the political process and thus can reasonably be expected to continue to exist in the form acceptable to most voters (both beneficiaries and workers), many workers now seem to be skeptical about the ability of that process to insure the social security system's permanence. Social security can be thought of as the social mechanism for caring for a large segment of the nonworking population (i.e., the retired, the disabled, and

their survivors) in face of the risks and uncertainties of advanced industrial society. Elderly and disabled people who can no longer work will always have to be provided for through one mechanism or another—by their children, through their own savings, etc. The current system assures that care of the nonworking elderly is partly a social responsibility, partly a private responsibility, and social security is simply the mechanism through which the social responsibility is met. It therefore seems likely that part of the fear about the long-term future of the system stems from a misunderstanding of the fundamental nature of the system, as well as from skepticism about the political process itself.

Pros and Cons of Terminating Social Security Coverage

Advantages of termination

For workers who withdraw from social security, the most immediate advantage is the increase in take-home pay resulting from ceasing to pay social security taxes. In most cases, this increase is a major selling point in convincing employees to seek withdrawal, especially when the employer provides some alternative pension plan that costs less than the social security tax rate. However, the advantages of this immediate pay increase must be balanced against what can be offered in place of social security through a private plan, even one that has similar costs. This comparison is discussed below in connection with the disadvantages of opting out, since it is not possible to match social security in the private market. It should be noted that State government plans, most of which have been in existence for many years, are in a better position to provide comparable coverage for more, though not all, employees than small plans offered by nonprofit employers.

What general advantages there may be for workers leaving social security lie in two areas: flexibility in retirement planning, for younger workers particularly; and realization of unintended subsidies, in two forms: windfalls for older workers who have worked in covered employment long enough to insure a retirement benefit from social security even if they stop paying social security taxes some years before they actually retire; and benefits that are not strictly wage-related, i.e., medicare and spouse benefits. The advantage of flexibility is, of course, simply the result of giving up the advantages of a universal social insurance program, while the windfalls are the result of particular features of the social security benefit structure that may be made more equitable in the future.

Individual flexibility.—For younger workers, it may appear that coverage offered by social security is broader than they might choose to purchase for themselves; full disability and survivor protection and fully indexed benefits are features of social security that private plans can not offer. Terminating social security coverage may allow young workers to devise their own plans that provide against only what they consider to be the most pressing or likely eventualities—such as retirement. They can thus take the money that would otherwise have gone to pay FICA taxes and invest it or spend it on immediate needs.

This line of reasoning is particularly appealing to high-wage younger workers, especially single workers, for whom the value of family and disability benefits may appear remote. However, the advantages of flexibility and individual choice must be traded off against

the advantages of a social insurance system. First, the social insurance system is guaranteed through the political process to pay benefits, while returns from private risk-taking investment by definition cannot be guaranteed. The choice is between the social insurance system that is determined through the political process, over which all citizens have some control, and private investment determined through the market process, which by its very nature is an impersonal mechanism over which individuals have no control.

It can be argued that individuals also have private insurance and substitute pension plans as alternatives to social security. However, private insurance and private plans alone proved inadequate in the past to provide against the risks incurred by most workers, and the entire structure of private pensions is predicated on provision of social security benefits as a base of protection. These plans by themselves could not provide the range of benefits social security currently provides for more than a very small minority of workers.

It is frequently argued that in the future, under various sets of economic and demographic assumptions, many workers now entering the labor force will receive a relatively low rate of return on their contributions, and that many high-wage workers could get a higher rate of return by investing their funds elsewhere. However, this argument confuses social insurance with annuity contracts; social security is insurance, not an investment plan.

The purpose of all insurance is to distribute both costs and risks among all subscribers. Social insurance requires workers to exchange small but certain payments for protection against large but uncertain risks through a national program. Naturally, the fortunate workers who do not die at a young age, or become unable to work before their mid-60's, will realize less of a return on their tax payments than the workers for whom these misfortunes are actually realized. The rate of return argument does not take into account the possibility that exists for all workers that they may not continue to earn high wages through an uninterrupted working career, which is the reason social security was established.

Furthermore, the notion that private investment will provide a better return than social security relies on the unstated assumption that only some workers can take advantage of the market process. If all workers are subject to the arbitrary process of market investments, some will win and some will lose, since all investments cannot result in equally high returns. It was precisely in order to protect workers against economic uncertainty and to provide some basic sharing of the risks of industrial society that social security was established. The fact that some workers could realize a higher rate of return in the marketplace cannot be used as a criticism of a system designed to share risks and returns among all workers.

It should also be noted that the advantages of individual control over funds that would otherwise be paid in FICA taxes are distributed generally according to level of income and wages. Social security's progressive benefit structure means that low-wage earners generally receive a higher return on their contributions to the system than high earners. This effect is consistent with the system's aim of providing a floor of income protection for all those who, for a variety of reasons including a lifetime of low wages or intermittent employment, are

unable to provide completely for their own retirement or inability to work. Thus, low and average wage workers, particularly those with families, are unlikely to be able to match what they would have received from social security.

Subsidized benefits.—The other general category of advantages for those who withdraw includes benefits that can be characterized as unintended subsidies, or windfall benefits. The term "windfall" is usually used to describe the advantage from the benefit formula accruing to those who work under social security only for a short time, particularly those with pensions from noncovered employment. However, two other types of benefits typically available to those who terminate their social security coverage can be seen as being subsidized for them by those who remain in the system: Medicare benefits, which are provided to all entitled beneficiaries who are either disabled or 65 and older, but which are not wage-related in amount; and dependent benefits available to the spouse of an entitled beneficiary.

The windfall for those with less than full careers under social security combined with substantial noncovered work can be seen as an anomalous result of workers being able to move between covered and noncovered employment. Medicare and spouse benefits, on the other hand, are simply not wage-related benefits, and thus would not be affected by termination of a worker's coverage once he or she was fully insured.

The windfall benefit is a direct result of the social security benefit formula, which does not distinguish well between workers with lifetime low earnings, and workers with less than a full career in covered work. The social security benefit formula is weighted toward low-wage earners, replacing 90 percent of the first bracket amount of monthly average indexed wages ($230 in 1982). Thus, an earnings history of 15 years, when spread over the 35-year averaging period for benefits, will result in a heavily weighted benefit, even if the worker was not a low-wage earner. Because the benefit formula gives much lower replacement of monthly earnings above this first bracket amount, the marginal return for higher-wage employees (in the form of higher benefits) on the additional taxes they would pay if they remained under the system would be less than they could realize by investing that money in conventional, risk-taking private markets (stocks, bonds, etc.).

This formula works as intended for those who remain in covered employment throughout their careers. In addition, the formula provides workers who have periods of unemployment that result in gaps in their earnings records (such as women who leave the labor force periodically to raise children, or workers who suffer periodic, involuntary unemployment) with some compensation in the form of weighted benefits. However, the formula results in unintended windfalls in cases where the worker has low covered earnings because he has a career in noncovered work for which he receives a pension.

These pensions, particularly Federal and State civil service pensions, are generally designed to take the place both of social security and a private pension plan for workers who remain in noncovered employment throughout their careers. Thus, a person eligible for such a pension will receive retirement income roughly equivalent to what social security and a private pension would give a worker with similar

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earnings under social security. If the noncovered worker in addition is eligible for a heavily weighted social security benefit, through moonlighting or through a relatively short career under social security, his total retirement pension income will most likely greatly exceed that of a worker with similar earnings all under social security.

A second major advantage for those with less than full careers covered by social security is entitlement to medicare, for which, like social security retirement benefits, a worker can become fully insured after only 10 years of covered earnings. However, the amount of medicare benefits is not linked to the worker's earnings record, but rather to the beneficiary's medical expenses, so that even minimal covered earnings will qualify a worker for full benefits. Again, this advantage accrues both to those with spotty earnings records, and to those with pensions from work not covered by social security, but it is an unintended subsidy for the latter group.

Finally, for many women workers not affected by the spouse's pension offset provision for Federal, State and local government workers, termination of coverage may have little or no effect on the amount of social security they will receive in retirement, if they are eligible for a wife's benefit as well. The social security dual entitlement rules prevent a worker from receiving both a full worker's benefit and a full spouse benefit (paid to the spouse of an entitled worker)—in effect, the spouse receives the higher of the two. Since most women workers still earn much less than men, and generally have more sporadic work histories, married women retirees typically receive the higher spouse's benefit.

Thus, women who are married to spouses in the covered work force are able to terminate their social security coverage and see no decrease in their retirement income, since their spouse benefit would be higher in any event. Of course, if the marriage ends in divorce after fewer than 10 years, the exwife is not entitled to a spouse benefit; if the marriage lasts at least 10 years, and the exwife does not remarry, she will be eligible for the benefit, but she cannot begin receiving benefits until her exhusband starts drawing benefits, or dies and she becomes eligible for a widow's benefit.

While these advantages are currently available to those who withdraw from the system, and play a major role in many employers' decisions to terminate coverage, it should be noted that Congress has shown a willingness to address unfair advantages received by one group of participants at the expense of others, and can be expected to continue to do so. Workers pressing their employers to terminate social security coverage have no guarantee that these advantages will continue to exist when they actually reach the age of eligibility.

In each of the cases cited above, specific legislation has been either proposed or enacted to reduce the advantage short-career workers have in the current system, although usually the legislation would affect only certain categories of employees and would not completely eliminate the advantages outlined above. For example, in his fiscal year 1983 budget proposals to Congress, the President proposed requiring Federal employees to pay the medicare portion of the social security tax; however, this proposal probably could not be extended to employees of State and local governments or of nonprofit groups without meeting the same arguments that have discouraged mandatory coverage of these employees under social security.

Some categories of workers are also not affected by the spouse's pension offset provision enacted in 1977, which, when it takes effect at the end of 1982 (unless proposals to delay its effective date are enacted before then) will essentially apply the dual entitlement principle to workers entitled to both a pension from work in Federal, State or local governments not covered by social security and to a social security spouse's benefit. This provision does eliminate the advantage of the social security spouse benefit for workers in State and local governments by reducing their spouse benefit $1 for each $1 in noncovered pension benefit. However, the provision does not apply to nonprofit employees, or to those not entitled to a pension from noncovered employment.

The windfall arising from the weighted benefit formula would be effectively eliminated for those with pensions from noncovered employment by section 301 of H.R. 3207, as approved by the Social Security Subcommittee on June 23, 1981. This provision was designed to give the worker with a noncovered pension a benefit that more accurately reflects his tax contributions to social security, by combining earnings records under both social security and the noncovered pension system, applying the benefit formula to that total, and then giving the worker that portion of the resulting benefit that reflects the percentage of the worker's career during which he paid social security taxes.

Disadvantages of termination

Termination of social security coverage means forfeiting the advantages of a nearly universal social insurance system. The major consequences for workers include the loss of specific features of social security that are difficult to replace, the creation of gaps in the worker's earnings record, and the possible loss of some or all pension protection because of the limited portability and varying vesting requirements of State and local and private plans.

The major consequence for employers is that they can realize substantial savings, depending on how much of social security's protections they attempt to provide for their employees. If they attempt to replace social security, they must bear individually or in small groups the cost of protecting their workers against the same risks social security does; the closer such a replacement plan comes to matching social security's protections, the more expensive and risky it becomes for employers to provide. Alternatively, employers may simply provide individual discretion for employees to provide for themselves, or they may provide more limited plans that give only retirement benefits, or limited other types of benefits. In either case, employers can clearly realize substantial financial gain, but only at the expense of most of their employees' pension and insurance protection.

It should be noted that in many cases the decision of a group to leave social security is heavily influenced by specific workers within the group for whom the advantages of windfall benefits outweigh the disadvantages of losing additional social security coverage. Yet the termination of coverage applies to all workers in the group, and to all future employees of that organization; thus the disadvantages of losing social security coverage will apply to substantial numbers of workers in virtually any large group that terminates coverage.

Replacing social security benefits.—Because social security is a social insurance program, many features of the system are an advantage to workers only on average, with some gaining more than others from family benefits, weighted benefits, disability benefits, etc. However, certain features of social security that apply to virtually all beneficiaries are either impossible or extremely difficult for small public plans or private plans to duplicate without prohibitive cost or risk of failure:

- Tax-free status of benefits;
- Indexing of initial benefit levels to increases in average wages, so that beneficiaries realize the gains of the general economy up to the time they begin receiving benefits (many private pension do this implicitly by basing benefits on final years of earnings, but workers who leave the employer after vesting but before the peak of their earnings power will not have their higher earnings reflected in their pensions);
- Indexing of current benefits (including survivor, disability and dependent benefits) to the cost of living;
- Medicare coverage.

Moreover, individual planning can only protect the worker against those risks he chooses to protect himself against. An individual deciding on specific insurance coverage will know whether he chose correctly only when it is too late to do anything about it. In contrast, the social insurance system provides benefits in the event of a very broad variety of circumstances which may not be predicted in advance, i.e., early death or disability, or divorce, which is particularly important in the case of women employees who may agitate for termination of coverage on the grounds that they will be eligible for spouse benefits on their husbands' records anyway. Social security also provides family protection which young workers may not anticipate needing but which may become valuable if, for example, both members of a married couple do not or cannot work steadily throughout their careers.

The social security benefit structure also gives some compensation through the weighting of the formula and the deletion of up to 5 years of low earnings from the computation to those who suffer periods of unemployment or employment at very low wages, such as part-time or temporary work. Finally, private plans typically cannot duplicate social security survivor benefits, particularly where the worker and the surviving dependents are young, nor do they usually provide indexed dependents' benefits for disabled workers.

Gaps in social security coverage.—A second problem created by termination is the gap created in the worker's social security earnings record. Workers whose social security coverage is terminated before they become fully insured (earn 1 quarter of coverage for each calendar year after 1950, or age 21, whichever is later, up to age 62) and who never work in covered employment again, will realize no benefit based on the FICA contributions they have already made. In addition, even those who are fully insured for retirement protection will lose disability protection in 5 years.

This loss is even more important if the replacement plan requires any substantial length of time for vesting: it is quite possible for workers to become disabled after losing social security protection and before becoming covered for any type of disability benefit under a new plan. This is particularly important for women workers who may

count on receiving social security spouse benefits on their husbands' records, since spouse benefits do not include either disability or survivor benefits.

Loss of portable pension protection.—A third major problem, directly related to the gap in social security coverage, is that private pension plan coverage is generally not portable. Because private pensions are funded independently by the specific employer involved (or group of employers in the case of multi-employer plans), rights accrued under one plan cannot generally be transferred, or built upon through work for another employer. Many plans do provide permanent rights to a pension of some sort at retirement if the worker stays with the employer long enough to accrue vested rights. However, deferred compensation plans of this sort cannot be viewed as providing real portable pension coverage, because they cannot compensate for inflation over the worker's whole working career. The amount of any deferred pension an employee retains after leaving a job is usually frozen despite subsequent inflation that would have been recognized by increasing the pension earned for those years if the employee had stayed in the job.

Moreover, workers who remain only a relatively short time (say 5 to 9 years) with the employer who has terminated social security coverage, and thus do not have vested pension rights, are severely disadvantaged. Even if they work for most of the rest of their careers in covered employment, they will realize little or no benefit from the contributions they made to a substitute plan while in their noncovered jobs, and they will receive lower social security benefits because of the gap in their earnings record. It is possible, of course, for high wage workers to use a short period of noncovered employment to their advantage, by investing the FICA tax money elsewhere at a high rate of return; however, as was discussed above, only a small minority of workers could expect to have both the wage patterns and the investment success necessary to take advantage of that opportunity.

In addition, workers can easily move from one noncovered job to another throughout a substantial working career and never acquire any basic pension protection, or social security coverage. If large numbers of hospitals terminated coverage, this pattern could be expected to occur for many hospital workers. The problem of portability is particularly acute for low and average wage workers who have little or no margin of income for savings that might compensate for the lack of private pension coverage, and for women who already may have substantial periods of no covered earnings because of childcare responsibilities.

Policy Considerations

About 11 percent—about 13.5 million—of all workers covered by social security are covered under voluntary agreements, and termination notices are now pending for fewer than 4 percent of this group. Therefore, the policy questions raised by the acceleration in termination requests have as much to do with impact on the workers involved and on attitudes toward the program in general as with the immediate concrete impact that terminations have on the social security trust funds.

It is clear that the trust funds stand to lose substantial revenues if the current pattern of filing termination notices continues, and if any

sizable percentage of those who file notices actually withdraw. If all organizations that currently have termination notices pending go ahead with the termination, the trust funds would lose on the order of $500 million each year (in 1982 dollars).

An equally important question, however, is how the provision of voluntary coverage for some groups of workers affects the function of social security as the Nation's basic social insurance system. The voluntary coverage provision can be seen as an anomaly in the context of a basically mandatory system, the result of congressional desires to extend coverage as quickly and with as little difficulty as possible to those employees who needed it most. As long as the elements of voluntarism had only a marginal effect on the operation of the system, the provision for optional coverage was seen as a benign opportunity for employees to obtain coverage when they otherwise would have been excluded. Serious questions have been raised about voluntary coverage only when employers have started to file for withdrawal in significant numbers and for reasons that appear to have more to do with reducing operating costs than providing basic, adequate protection for all employees.

Some distinction can be drawn between the reasons for voluntary participation by State and local governments, which involves possible constitutional issues of Federal taxation of the States, and for 501(c)(3) nonprofit groups, which were covered voluntarily as a result primarily of political rather than constitutional considerations. In both cases, however, voluntary participation works as intended only when the interests of all employees in a group, both long-term and short-term, present and future, and the interests of society at large are the paramount considerations in deciding for or against coverage. For example, private pension plans alone could not provide well for workers who move from job to job frequently; in this case, both individual interest and social policy may be best served by providing social security coverage for such workers, who might otherwise have to rely on needs-tested programs in the absence of pension benefits when they retire.

However, the terms of participation in social security are not determined by the employees according to the kind of benefit protection they want, but by the employer according to the kind of fringe benefits he wishes to provide to specific employees. The employer may view the worker who leaves after a relatively short time as a marginal employee for whom he has little interest in providing attractive pension benefits. Yet from the point of view of social policy, that employee needs basic social insurance protection as much as a worker who stays at one job his entire career. In this case, it is clear that the interests of the employer who wishes to retain career employees with a good benefit package may not be consistent with overall social policy, or with the interests of all his employees, both present and future.

A second area of general concern is the resentment created by voluntary withdrawals from the system among workers covered on a mandatory basis. In particular, the shifting of the tax burden of social security from those workers who withdraw, but who remain entitled to future benefits based on their past earnings, to workers who remain in the system is seen as inequitable. It also appears inconsistent that society views social insurance as such a basic program than participation is mandatory for most, like the rest of the tax system, yet for some workers participation is optional. Regardless of their opinion about objective merits of social security coverage, those who must pay the taxes will inevitably view optional participation as unfair.

Finally, the discriminatory impact of termination of coverage on employees at different wage levels is a question of some importance. The social security system serves various social goals, among them a degree of income redistribution: lower wage workers receive benefits that represent a higher return on their payments into the system than high wage workers realize. One result of this formula is that low wage workers are assured a reasonable minimum floor of benefit income, in recognition of the facts that they had less margin of disposable income during their working careers than higher wage workers to build up savings and investments, and that they are less likely to be covered by private pensions. This effect can be said to reflect a deliberate policy of providing basic income maintenance for low wage workers through a wage-related system rather than through needs-tested programs.

If social security coverage is terminated for substantial numbers of employees, low wage workers will be much more adversely affected than high wage workers, since private replacement plans are generally based on giving a uniform rate of wage replacement to employees at all wage levels. If low wage workers reach retirement age without social security protection, they may face very inadequate benefits, and will have to be supported through means-tested programs. Given the lack of portability of private pension plans, even average wage workers who have changed jobs more than once during their careers may have to resort to such programs in the absence of social security. The social policy issue in this case is whether it is appropriate to allow termination decisions made by employers based primarily on short-term cost considerations to shift the burden of caring for their elderly and disabled employees from a wage-related program that essentially rewards work to means-tested programs that do not.

Legislative Responses

There are several possible legislative responses to the problems arising from current trends of terminating social security coverage, including extending coverage to these groups mandatorily, eliminating the option to withdraw from social security for those already covered, and placing further restrictions on employers' ability to terminate coverage. The groups affected by these solutions may argue against them on the grounds that they are all forms of mandatory coverage, since they all limit the employer's ability to leave the system to one degree or another.

However, it can also be argued that the conditions under which the voluntary termination provision was originally enacted have changed so much that the original reasons for allowing terminations may no longer apply:

(1) Substantial windfall advantages that were not possible when coverage was extended voluntarily in the 1950's can now accrue to some employees who withdraw; and

(2) Because the cost of the system has increased greatly since 1950, the interests of employees who would be disadvantaged by termination are being sacrificed by employers for the sake of lower operating costs. The current trend of terminations can be attributed in large part to the willingness of State and local governments and nonprofit hospitals to alleviate financial hardship by replacing social security with plans that benefit some employees at the expense of others.

At the time the voluntary termination provisions were passed, it was judged that the constitutional and political arguments in favor of optional coverage for these groups outweighed the disadvantages from both individual and social policy points of view. It may now be judged, by both the Congress and the courts, that the disadvantages resulting from terminations are enough to counterbalance the arguments against Federal taxation of State entities.

It also seems clear that the issue of mandatory coverage of certain nonprofit organizations is separate in many ways from the State and local government issue, and that there appears to be no constitutional bar to mandatory coverage of at least some of these organizations. A legal memorandum contained in the 1980 report of the Universal Coverage Study Group (pp. 261–265) suggests that mandatory coverage of nonprofit groups is generally constitutional, except in the case of religious groups with explicitly held religious views opposing coverage, which could be provided specific exemptions from mandatory coverage. This line of reasoning is strengthened by the recent U.S. Supreme Court decision in *United States* v. *Lee*, in which an Amish employer was compelled to pay the employer share and to withhold the employee share of the FICA tax for his employees notwithstanding his religious objections to coverage for himself. The problems involved in attempting to cover employees of reorganizing or disappearing nonprofit entities may be addressed by making some distinction, perhaps through an automatic trigger based on number of employees, between established and enduring nonprofit organizations, such as hospitals, and temporary entities such as small philanthropic groups that organize for a specific purpose and then disband.

Eliminating the Option to Terminate Coverage

Section 302 of H.R. 3207, introduced by Chairman J. J. Pickle in 1981, would eliminate the option to terminate coverage for State and local governments and nonprofit organizations. The effective date for this provision, agreed to by the Social Security Subcommittee both in informal meetings in March 1981, and in a formal vote approving the provision on June 23, 1981, renders void any notice filed after March 25, 1981, which was the first day the provision was made public.

Two issues have been raised in connection with this provision beyond the general question of whether allowing groups to be covered voluntarily is desirable: First, will elimination of the withdrawal option withstand a constitutional challenge? and second, is the March 25, 1981, effective date equitable and reasonable?

Some groups would probably be inclined to challenge the provision on the grounds that it unilaterally changes the conditions of voluntary agreements between State and local governments and the Federal Government. Challenges of this nature do not appear to involve any constitutional issues. Since nonprofit groups are covered through a waiver of tax-exempt status, it is not clear whether any considerations of changing the conditions of coverage would apply to them, whether or not such arguments involve constitutional issues.

With respect to a direct constitutional challenge, it can be argued that a simple abolition of State and local governments' right to withdraw from social security infringes on State rights. However, it can be argued in opposition that the goal of equal treatment of all workers regardless of their condition of employment at various points in their

careers outweighs the possible States rights question. In any event, however Congress chooses to act in this connection, the constitutional ramifications can ultimately be decided only by the Supreme Court if the parties involved choose to pursue the issue that far.

The second question, concerning the March 25, 1981, effective date, has created considerable discussion. The Subcommittee discussed this date during the markup session on the provision in June 1981, and ultimately accepted the reasoning that delaying the effective date further would essentially defeat the purpose of eliminating the option, since presumably there would be a rush to terminate before the effective date. Such a delay would also have given an unfair advantage to those employers who were informed about the provision over those who are not. Since approval of the provision, large numbers of employers have filed termination notices, apparently as "insurance" against possible final passage of the provision with a later effective date. Thus, the effect of changing the March 25 date at this point will be to provide termination of coverage for large numbers of employers who otherwise would have been prevented from leaving the system.

Mandatory Coverage

Mandatory coverage of State and local government and nonprofit employment would not only solve the termination problem, but would eliminate windfall benefits for those newly covered, and would fill the gaps in protection of those who move between covered and noncovered employment. Contributions and benefits provided under staff retirement systems for groups not now covered under social security could be adjusted to take account of social security coverage and contributions. Coordinated coverage under social security and a staff retirement system would assure that benefits under both systems would be reasonably related to a worker's lifetime earnings and contributions.

Despite the possible advantages, mandatory coverage raises broader issues than the more limited action of eliminating the voluntary termination provision. Covering noncovered workers by social security ideally requires restructuring any existing pension systems to accommodate provision of social security benefits, a procedure that can be complex and time-consuming. In addition, an active extension of coverage to State and local employees and nonprofit employees, rather than a simple freeze on the ability to terminate coverage, would inevitably raise the issue of covering Federal workers as well, especially since covering Federal workers would involve none of the constitutional issues raised by covering State and local government employees.

It is clear that all of the problems of windfalls and gaps in protection that are now being addressed through a variety of offset proposals would be more simply solved by universal coverage. However, the political implications of universal coverage are wide-ranging, and may make it much more difficult to enact and implement than the provision to eliminate voluntary terminations. When the Committee on Ways and Means reported a bill to the House floor extending social security coverage to Federal, State and local government and nonprofit employees in 1977, the provision was eliminated by a floor vote of 386 to 38; the bill, later passed into law, mandated instead the Universal Coverage Study Commission report on the advisability and feasibility of universal coverage.

This report was issued in 1980, and while no specific recommendations were made, most of the technical issues involving universal coverage were explored in it, as well as in a recent report prepared on the subject by the Congressional Research Service for Senator Stevens, and it is clear that the technical problems of integrating social security and public pension plans can be resolved. Recent public opinion polls (Harris, etc.) have shown overwhelming public support for coverage at least of Federal workers; however, most Federal employee unions have remained opposed to such a move.

Restrictions on Termination Activity

Several alternatives also exist that are much less extensive than the H.R. 3207 provision, and that can be categorized as restrictions on the employer's ability to file for termination. These include requiring notification of employees that the employer intends to file a termination notice, requiring a referendum of employees on the subject of withdrawal prior to filing a termination notice, and requiring the employer to provide a substitute pension plan that can be certified by an independent actuary as protecting all employees equally and as well as social security. Such restrictions would provide some measure of protection for the employees involved and would be consistent with the policy of the Congress, enunciated when coverage was first made available to State and local employees, that there be no impairment of protection of State and local retirement system members by reason of the extension of social security coverage to their employment.

Enactment of any new restrictions on a State's right to withdraw would raise the issue of whether the provision altered the terms of the State's coverage agreement without the State's consent, just as the elimination of voluntary termination would. Restrictions on nonprofit groups would not necessarily raise the same issues, since the act of filing a limited waiver of nonprofit status with IRS may not be considered equivalent to the State-Federal contractual agreements. However, since individual nonprofit employers would be hard put to develop substitute plans that would replace social security completely for all their employees, such provision could be tantamount to eliminating the ability to terminate coverage. On the other hand, the judgment of whether a plan was completely equivalent to social security would be laden with controversy in each individual case, and such a requirement might well create large political and administrative problems for the systems required to produce the plan, and for the government in making a judgment on each plan.

Requirements for notification or employee referendums would not have a similar effect. While some cases have recently been brought to light in which certain nonprofit hospitals filed for termination and did not notify the affected employees, any requirement for notification seems likely to insure debate over termination but to still leave the outcome primarily dependent on the desires of the employer. Requiring a referendum of employees to approve any termination of coverage would insure that employees would have a say in the decision. However, the social policy considerations involved in allowing voluntary terminations would not be resolved by allowing the matter to be settled by employee referendums, since the decisions of individual employees would not necessarily be consistent with their own long-term interests, the interests of future employees of the group or the interests of the society as a whole.

State and local governments

The Social Security Act of 1935 excluded from coverage all employment for States and localities, primarily because of the question of the constitutionality of any general levy of the employer tax on States and localities. During the 1940's a consensus emerged that coverage of these employees could be accomplished most easily through voluntary agreements with State and local governments. The Social Security Act Amendments of 1950 made social security coverage generally available for periods after 1950 to those employees of States and their political subdivisions not covered under a State or local retirement system.

The original House version of H.R. 6000 (the 1950 Amendments) permitted coverage of persons already under a retirement system if a written referendum were held on the question of coverage, and not less than two-thirds of the voters in such a referendum voted in favor of inclusion. This provision was seen by the officers and representatives of the State and local retirement systems (primarily those of policemen, firemen and teachers) as a danger to the existing systems, since the local governments might not support two retirement systems if social security coverage were extended to their employees. In its report on H.R. 6000, the Senate Finance Committee stated that "Your Committee has received overwhelming testimony against permitting such coverage and has so specifically prohibited it." The Senate version prevailed in the final conference agreement.

The 1950 Amendments provided that social security coverage for State and local employees could be secured only for groups of employees called "coverage groups." This limitation was designed to prevent selection against the social security program by specific types of employees or individual employees. In general, all of the employees of a State or of a political subdivision not under an existing retirement system constituted a coverage group, and, with some minor exceptions, all of the employees in a group had to be covered if any were to be covered.

Consistent with the voluntary approach to coverage of these groups of employees, the 1950 Amendments also provided that a State could terminate the coverage of its own employees or of the employees of any political subdivision, at the instigation either of the State or at the request of the political subdivision itself. No provision was made, either in these amendments or later, for mandating a referendum of affected employees or for mandating notification of affected employees before terminating coverage.

After enactment of the 1950 Amendments, several States and a large number of local governments secured social security coverage for their employees who were already under a retirement system (and thus prohibited from coverage) by dissolving the existing system before bringing the group under the Federal-State agreement. At least partly in response to this activity, the 1954 Amendments made coverage available to State and local government employees in groups covered by an

existing retirement system, subject to a referendum in which coverage was approved by a majority of those voting. All members of the group had to be covered. Policemen and firemen, at the request of their representatives, continued to be excluded from coverage.

This legislation made it possible for employees of State and local governments to have coordinated protection under State and local systems and social security. In general, the existing retirement system was modified to take account of receipt of social security, either by reducing contributions and benefits, or by offsetting the system's benefits against some portion of the social security benefits payable.

The 1956 Amendments established the "divided retirement system" provision, which permits specified States (currently 21 specified States and all interstate instrumentalities) to extend coverage only to those members of a group already covered by a retirement system who desired coverage, with compulsory coverage provided for all persons who later became members of the retirement system group. The Amendments also made an exception to the specific exclusion from coverage of policemen and firemen who are under an existing retirement system, permitting them to be covered in specified States (currently 22 specified States, Puerto Rico, and all interstate instrumentalities). Finally, in 1967 the law was amended to permit all States to provide social security coverage for firemen who are covered under a State or local retirement system, if certain conditions in the law are met.

Nonprofit groups

Nonprofit groups operating exclusively for religious, charitable, or other public goals (as defined now by Section 501(c)(3) of the Internal Revenue Code) were exempted from coverage under the 1935 and 1939 acts. Employees of other types of nonprofit groups, such as civic leagues, labor unions, credit unions, etc., have always been covered compulsorily. A 1946 report to the Committee on Ways and Means states that 501(c)(3) groups were exempted because such an exemption ". . . was requested by representatives of religious, educational and philanthropic institutions. They feared endangering their freedom from taxation and the separation of church and state; they feared extension of Government influence on religious and educational policies and contended that anything paid by nonprofit organizations for social-benefit purposes would decrease dollar for dollar what they could use for the public services for which they were organized."

As early as 1940, however, various bills were being introduced at the request of religious groups to provide for compulsory coverage of nonprofit employees, and the compulsory payment of the employer's share of the tax. It had apparently become difficult for these employers to attract employees in face of the lack of pension coverage, and the advantages of social security coverage seemed to outweigh the possible precedent on taxation. The 1948 Advisory Council report strongly recommended compulsory coverage, arguing that such coverage need not have any impact on the organization's general tax status, since the social security tax is a special-purpose tax that has no relation to other types of taxation from which the organization may be exempt.

Both the House and Senate versions of H.R. 6000 provided for coverage of these groups, but in substantially different ways. The House

provided for compulsory taxation of employees, and voluntary taxation of employers, so that where the employer did not contribute, only half of the employees' wages

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Appendix B: Termination Experience

Participation since 1950

During the first two decades after voluntary participation was allowed, coverage of State and local and nonprofit groups expanded dramatically, and very few took the opportunity to withdraw. By the early 1980's most States had made coverage agreements and the percentage of State and local employees covered under social security reached 70 percent; a similar pattern appears to have occurred with respect to nonprofit groups. Until the mid-1970's, the number of employees leaving the system was always greatly exceeded by the number of newly-covered employees—in most years, by 50,000 or more. Moreover, many terminations were caused by consolidation of local jurisdictions, or changes in the status of nonprofits groups, rather than by withdrawal from the social security system.

The reasons for this widespread desire to enroll in the program during this period are not specifically documented, but it can be inferred that most employers desired to be covered if their already established pension plans could not be supplanted. For nonprofit organizations, most of whom offer pension plans of the scope generally available to State and local government employees, coverage was an inexpensive benefit that could be offered at relatively low cost and without implications for the organization's tax exempt status.

However, as shown on Table 1, 1976 was the last year that newly-covered positions exceeded the number of terminated positions and in the six years since then, numbers of positions being terminated from coverage have exceeded the numbers of newly-covered positions. This reversal is due at least in part to the fact that coverage had finally been extended by the mid-1970's to those employees most in need of coverage, which was of course the original notion underlying voluntary participation. As Table 2 shows, coverage of State and local employees has remained fairly constant at 70–72 percent for over 10 years.

The number of governments filing termination notices did increase in conjunction with widespread concern about the financial condition of social security that preceded the 1977 Amendments, as shown on Table 3. While this rate of filing slowed down after the 1977 amendments, considerable acceleration in filing for terminations for State and local governments has occurred since 1980, again in conjunction with widespread concern about the financial viability of the trust funds, and about the economy in general.

Similary historical figures are not available for nonprofit oranizations, because notices of terminations for nonprofits are filed with regional offices of the Internal Revenue Service, and IRS and SSA only began coordinating this data in 1981. It is estimated that over the years a total of about 160,000 organizations have waived their tax-exempt status and provided coverage for their employees; coverage has been terminated for 159 of these, and there are 739 termination notices pending as of May 1982.

It should be noted that these figures represent the number of organizations that have filed notices of termination which may be withdrawn at any time during the 2-year waiting period. Table 1 does not reflect a significant percentage of groups filing notices which are withdrawn before they become effective; because of the large recent upswing in the rate of filing, it is unclear whether the 20-percent reversal rate will hold or increase.

TABLE 1.—NUMBER OF STATE AND LOCAL GROUPS AND EMPLOYEES NEWLY COVERED UNDER SOCIAL SECURITY COMPARED TO THOSE WHOSE COVERAGE HAS BEEN TERMINATED, 1967–81

Year	Newly covered [1]		Terminated		Net gain or loss of coverage
	Groups	Employees	Groups	Employees	
1967	1,000	67,473	11	323	+67,150
1968	1,717	78,925	14	363	+78,562
1969	958	34,351	20	1,262	+33,089
1970	1,031	38,116	20	2,402	+35,714
1971	1,021	41,778	30	2,530	+39,248
1972	944	34,281	41	6,331	+27,950
1973	709	20,281	35	4,549	+15,732
1974	621	21,281	69	8,849	+12,432
1975	1,057	17,010	45	13,199	+3,811
1976	762	20,000	54	8,117	+11,883
1977	675	17,000	135	25,196	−8,199
1978	722	17,050	112	20,608	−3,558
1979	596	14,300	78	33,584	−19,284
1980	617	11,961	96	21,651	−9,690
1981	580	15,963	86	20,707	−4,744
Total	13,180	533,023	858	171,574	+361,449

[1] Represents only groups and employees of groups newly covered—not growth in numbers of covered employees in groups covered in previous years.

TABLE 2.—SOCIAL SECURITY COVERAGE OF EMPLOYEES OF STATE AND LOCAL GOVERNMENTS, 1951–81

(1st calendar quarter; employees in thousands)

Year	All employees	Covered employees	Percent covered
1951	3,623	414	11
1952	4,053	622	15
1953	4,053	782	19
1954	4,145	944	23
1955	4,807	1,088	23
1956	5,004	1,418	28
1957	5,223	2,047	39
1958	5,558	3,021	54
1959	5,841	3,252	56
1960	6,087	3,561	59
1961	6,384	3,823	60
1962	6,613	4,278	64
1963	6,948	4,705	68
1964	7,173	4,864	68
1965	7,623	5,041	66
1966	8,127	5,429	67
1967	8,791	5,824	67
1968	9,195	6,291	68
1969	9,438	6,581	69
1970	9,824	6,876	70
1971	10,265	7,286	71
1972	10,696	7,699	72
1973	11,160	8,085	72
1974	11,481	8,266	72
1975	11,976	8,623	72
1976	12,178	8,768	72
1977	12,252	8,796	72
1978	12,889	9,230	72
1979	12,983	9,259	71
1980 [1]	13,194	9,368	71
1981 [1]	13,257	9,412	71

[1] Preliminary.

TABLE 3.—NUMBER OF STATE AND LOCAL GOVERNMENT TERMINATIONS OF SOCIAL SECURITY COVERAGE, 1959–82 [1]

Year terminated	Entities	Employees
1959	1	3
1960	0	0
1961	1	5
1962	0	0
1963	2	41
1964	10	132
1965	4	105
1966	5	33
1967	11	323
1968	14	863
1969	20	1,262
1970	29	2,493
1971	33	2,837
1972	41	6,951
1973	35	4,939
1974	69	8,849
1975	45	13,199
1976	54	8,117
1977	135	25,196
1978	112	20,603
1979	78	33,584
1980	96	21,651
1981	86	20,707
1982 [2]	[2] 126	[2] 85,679
Total	[2] 1,007	[2] 257,572

[1] 1st termination occurred in 1959.
[2] Projected. Based on notices of intent to terminate received by Dec. 31, 1981.

Recent activity

Tables 4 through 10 summarize recent termination activity of State and local governments and nonprofit groups, as well as some historical data for State and local government terminations. Reliable data before 1981 for termination experience for nonprofit groups is not available; however, Table 9 shows Census Bureau and Social Security Administration data on total numbers of nonprofit organization employees in 1977 in covered and noncovered employment.

As of December, 1981, coverage had been terminated for 881 State and local government entities, and for approximately 171,700 employees; there are currently pending, through December, 1984, 308 State and local government termination notices affecting approximately 148,628 employees. The three most active States in past terminations were California, Louisiana and Texas, with 74 percent of all entities that have terminated coverage; California, Georgia and Texas are the most active States in current termination activity, with 59 percent of all entities with pending termination notices.

State	Active political subdivisions pending termination	Percent of the State's total active political subdivisions
Texas	53	4.4
California	85	3.5
Washington	35	3.5
Georgia	45	3.0

As noted above, the rate of filings for termination of coverage has accelerated considerably since 1979, for a variety of reasons discussed above. It should be particularly noted that nonprofit hospitals have been the focus of intensive activity on the part of consulting firms marketing plans for terminating social security coverage and substituting some form of more limited coverage for employees. These firms have been able to take advantage of the widespread concern about the financing of social security, and the rising cost of the program at a time when hospitals are under strong pressure to control costs, despite the difficulty of substantiating their claims for providing substitute plans that provide benefits comparable to social security.

It should also be noted that an immediate impetus to file termination notices was probably created by the action taken by the Social Security Subcommittee in 1981 to eliminate the option to withdraw as of March 25, 1981. Since that date, as noted above, the number of nonprofit groups filing for withdrawal has more than tripled, and a large part of this activity can be attributed to organizations filing notices now, and leaving open the option to actually withdraw, on the assumption that the March 25 date will be delayed.

TABLE 4.—CUMULATIVE TERMINATIONS, 1959–81 [1]

	Filed notice of intent to terminate by December 1979		Terminated as of 1981		Withdrew notice to terminate	
	Jurisdictions	Employees	Jurisdictions	Employees	Jurisdictions	Employees
Alaska	15	17,609	11	15,424	4	2,183
Arizona	3	769	0	0	3	769
Arkansas	1	132	0	0	1	132
California	361	83,245	316	49,230	45	34,015
Colorado	29	2,398	22	1,656	7	742
Delaware	2	1	1	1	1	.....
Florida	4	4,573	1	888	3	3,685
Georgia	73	44,649	46	19,705	27	24,944
Illinois	1	1	1	1	0	0
Indiana	13	172	13	172	0	0
Kansas	5	2,825	4	134	1	2,691
Kentucky	4	54	3	54	1	0
Louisiana	235	62,085	203	46,122	32	15,963
Maine	17	885	14	778	3	107
Maryland	7	10,906	1	5	6	10,901
Massachusetts	1	10	1	10	0	0
Michigan	7	4,241	3	21	4	4,220
Mississippi	2	476	1	62	1	414
Missouri	20	5,442	16	122	4	5,320
Nebraska	2	18	2	18	0	0
Nevada	11	285	11	285	0	0
New Mexico	2	297	2	297	0	0
New York	33	417,989	0	0	33	417,989
North Carolina	4	2,124	1	20	3	2,104
North Dakota	2	28	2	28	0	0
Oklahoma	18	5,179	13	457	5	4,722
Pennsylvania	1	19	0	0	1	19
Tennessee	7	150	7	150	0	0
Texas	157	39,573	144	32,914	13	6,659
Utah	7	1,090	6	814	1	276
Virginia	1	18	1	18	0	0
Washington	35	2,259	32	2,210	3	49
Wyoming	2	144	1	68	1	76
Interstate instrumentality	3	213	2	77	1	136
Total [2]	1,085	709,857	881	171,741	204	538,116
Percent			81	24	19	76

[1] Termination generally becomes effective 2 years after notice filed.
[2] 709,857/1,085=654=average size of groups for whom notice was filed. 171,741/881=195=average size of terminating group. 538,116/204=2,638=average size of groups for whom notice to terminate withdrawn.

TABLE 5.—COMPARISON OF NUMBER OF STATE AND LOCAL GOVERNMENT EMPLOYEES COVERED, TERMINATED, AND PENDING TERMINATION, BY STATE

State	Employees for whom coverage had been terminated as of December 1977	Employees covered as of October 1977	Employees for whom coverage has been terminated December 1977 through December 1981	Employees for whom termination is pending through December 1984
Alabama	0	123,404	0	305
Alaska	0	12,321	15,424	1,783
Arizona	0	97,976	0	0
Arkansas	0	68,995	0	0
California	32,520	515,646	16,710	88,180
Colorado	828	28,842	828	2,186
Connecticut	0	60,134	0	0
Delaware	0	23,974	1	0
District of Columbia	0	40,102	0	0
Florida	0	322,750	888	3,354
Georgia	1,660	182,213	18,045	29,742
Hawaii	0	29,102	0	0
Idaho	0	31,403	0	0
Illinois	1	137,113	0	0
Indiana	20	151,442	152	92
Iowa	0	109,224	0	0
Kansas	0	86,336	134	723
Kentucky	4	86,902	50	0
Louisiana	29,456	32,921	16,625	933
Maine	490	11,761	288	0
Maryland	5	176,938	0	0
Massachusetts	10	9,487	0	0
Michigan	0	290,645	21	706
Minnesota	0	123,779	0	0
Mississippi	0	71,831	62	1,085
Missouri	8	123,920	114	2
Montana	0	32,529	0	0
Nebraska	0	59,687	18	113
Nevada	233	373	52	6
New Hampshire	0	23,960	0	0

TABLE 5.—COMPARISON OF NUMBER OF STATE AND LOCAL GOVERNMENT EMPLOYEES COVERED, TERMINATED, AND PENDING TERMINATION, BY STATE—Continued

State	Employees for whom coverage had been terminated as of December 1977	Employees covered as of October 1977	Employees for whom coverage has been terminated December 1977 through December 1981	Employees for whom termination is pending through December 1983
New Jersey	0	214,056	0	0
New Mexico	0	53,381	297	186
New York	0	646,184	0	0
North Carolina	0	194,295	20	23
North Dakota	0	22,361	28	0
Ohio	0	25,309	0	0
Oklahoma	0	96,695	457	36
Oregon	0	98,689	0	0
Pennsylvania	0	345,139	0	0
Puerto Rico	0	125,766	0	0
Rhode Island	0	23,231	0	0
South Carolina	0	111,378	0	0
South Dakota	0	24,834	0	5
Tennessee	150	147,417	0	197
Texas	7,770	259,983	25,144	11,022
Utah	1	48,509	813	1,243
Vermont	0	12,903	0	0
Virginia	0	205,528	18	0
Virgin Islands	0	771	0	0
Washington	2,040	141,800	170	6,511
West Virginia	0	68,820	0	0
Wisconsin	0	166,349	0	0
Wyoming	0	20,398	68	195
Interstate instrumentalities	0	14,562	77	0
Total	75,196	6,134,068	96,504	148,628

TABLE 6.—SOCIAL SECURITY COVERAGE AND TERMINATIONS FOR STATE AND LOCAL EMPLOYEES

Year	Employees covered [1]	Employees terminated [2]	Percent of employees terminated
1959	3,252,000	3	0.0001
1960	3,561,000	0	.....
1961	3,823,000	5	.0001
1962	4,278,000	0	.....
1963	4,495,000	41	.0009
1964	4,860,000	132	.0027
1965	5,041,000	105	.0021
1966	5,528,000	33	.0006
1967	5,854,000	323	.0055
1968	6,261,000	863	.0138
1969	6,531,000	1,262	.0193
1970	6,876,000	2,493	.0363
1971	7,288,000	2,837	.0389
1972	7,699,000	6,951	.0903
1973	8,035,000	4,935	.0614
1974	8,266,000	8,849	.1071
1975	8,623,000	13,199	.1531
1976	8,768,000	8,117	.0926
1977	8,796,000	25,196	.2864
1978	9,230,000	20,603	.2232
1979	9,259,000	33,584	.3627
1980	9,368,000	21,651	.2311
1981	9,412,000	20,707	.2200

[1] Rounded to nearest thousand. Figures are for employees in the 1st calendar quarter—before terminations became effective.
[2] Through 4th calendar quarter.

TABLE 7.—VOLUNTARY TERMINATIONS PENDING, EFFECTIVE DECEMBER 1982 TO DECEMBER 1984

State	Entities	Approximate number of employees
Alabama	2	305
Alaska	12	1,783
California	85	88,180
Colorado	12	2,186
Florida	3	3,354
Georgia	45	29,742
Indiana	3	92
Kansas	4	723
Louisiana	18	933
Michigan	8	706
Mississippi	4	1,085
Missouri	1	2
Nebraska	2	113
Nevada	1	6
New Mexico	1	186
North Carolina	1	23
Oklahoma	2	36
South Dakota	1	5
Tennessee	2	197
Texas	53	11,022
Utah	12	1,243
Washington	35	6,511
Wyoming	1	195
Total	308	148,628

TABLE 8.—NONPROFIT ORGANIZATIONS PENDING TERMINATION OF COVERAGE

[H=hospitals; O=other nonprofit groups]

[By quarter of termination]

Region	Mar. 31, 1982		June 30, 1982		Sept. 30, 1982		Dec. 31, 1982	
	H	O	H	O	H	O	H	O
Boston	0	2	1	0	0	0	0	2
New York	0	1	0	2	2	1	5	3
Philadelphia	1	3	3	5	0	3	5	1
Atlanta	4	5	2	4	0	2	3	6
Chicago	0	2	0	2	0	0	3	6
Dallas	1	4	0	4	1	4	7	3
Kansas City	0	0	0	3	0	4	3	0
Denver	1	3	0	2	2	2	1	1
San Francisco	4	8	4	5	1	6	7	7
Seattle	0	3	0	1	1	2	1	2
Total	11	31	10	28	7	24	35	31

	Mar. 31, 1983		June 30, 1983		Sept. 30, 1983		Dec. 31, 1983	
	H	O	H	O	H	O	H	O
Boston	5	1	0	2	2	3	5	3
New York	5	2	9	4	7	5	8	1
Philadelphia	5	4	9	8	10	4	7	8
Atlanta	2	8	0	7	13	9	6	8
Chicago	26	6	9	8	30	6	22	12
Dallas	4	3	13	14	2	3	4	9
Kansas City	6	4	4	1	9	3	11	7
Denver	2	3	4	5	2	5	14	2
San Francisco	10	18	7	16	5	8	8	14
Seattle	0	7	5	2	8	3	4	8
Total	65	56	60	67	88	49	89	72

TABLE 8.—NONPROFIT ORGANIZATIONS PENDING TERMINATION OF COVERAGE—Continued

[H=hospitals; O=other nonprofit groups]

[By quarter of termination]

Region	Mar. 31, 1984		June 30, 1984		Sept. 30, 1984		Dec. 31, 1984	
	H	O	H	O	H	O	H	O
Boston	1	3						
New York								
Philadelphia	1						1	
Atlanta		1						
Chicago	1							
Dallas	2	1						
Kansas City	1							
Denver		1						
San Francisco	1	1						
Seattle		1						
Total	7	8					1	

	1982–84 total	Hospitals			Other		
		1982	1983	1984	1982	1983	1984
Boston	30	1	12	1	4	9	3
New York	55	7	29	0	7	12	0
Philadelphia	78	9	31	2	12	24	0
Atlanta	80	9	21	0	17	32	1
Chicago	133	3	87	1	10	32	0
Dallas	79	9	23	2	15	29	1
Kansas City	56	3	30	1	7	15	0
Denver	50	4	22	0	8	15	1
San Francisco	130	16	30	1	26	56	1
Seattle	48	2	17	0	8	20	1
Total	739	63	302	8	114	244	8

TABLE 8.—NONPROFIT ORGANIZATIONS PENDING TERMINATION OF COVERAGE—Continued

	Number
Total hospitals 1982	63
Total other 1982	114
Total 1982	177
Total hospitals 1983	302
Total other 1983	244
Total 1983	546
Total hospitals 1984	8
Total other 1984	8
Total 1984	16
Total hospitals 1982–84	373
Total other 1982–84	366
Grand total 1982–84	739

TABLE 9.—NONPROFIT HOSPITALS PENDING TERMINATION

Region	Hospitals pending termination	Hospitals for which data were available	Employees	Total payroll (thousands)
		1982		
Boston	1	1	195	$2,127
New York	7	7	6,536	74,227
Philadelphia	9	9	9,993	91,564
Atlanta	9	9	7,083	67,213
Chicago	3	3	1,785	9,170
Dallas	9	6	6,152	53,979
Kansas City	3	3	890	6,932
Denver	4	4	1,988	13,949
San Francisco	16	15	11,309	132,000
Seattle	2	2	938	10,937
Total	63	60	46,119	451,803
		1983		
Boston	12	11	5,482	$57,629
New York	29	27	23,464	286,583
Philadelphia	31	31	26,338	259,103
Atlanta	21	20	18,364	206,560
Chicago	87	85	62,316	649,056
Dallas	23	20	17,250	177,302
Kansas City	30	28	21,528	240,040
Denver	22	19	9,008	100,848
San Francisco	30	28	21,103	253,663
Seattle	17	16	10,323	102,508
Total	302	285	220,176	2,373,292
		1984		
Boston	1	1	391	$3,983
New York				
Philadelphia	2	2	829	8,907
Atlanta				
Chicago	1	1	146	1,482
Dallas	2	1	6,312	53,858
Kansas City	1	1	313	2,978
Denver				
San Francisco	1	1	851	8,693
Seattle				
Total	8	7	8,842	80,711

TABLE 10-A.—NUMBER OF WORKERS IN NONPROFIT ORGANIZATIONS, BY CENSUS BUREAU INDUSTRY CLASSIFICATION, MARCH 1977

Census Bureau industry classification	Workers (thousands)
Hospitals	2,195
Convalescent institutions	225
Elementary and secondary schools	702
Colleges and universities	657
Educational services, not elsewhere classified	14
Religious organizations	619
Welfare services	116
Residential welfare facilities	91
Nonprofit membership organizations	8
Miscellaneous professional and related services	96
Total	4,770

Note: Data based on estimates of nonprofit employment in Census Bureau industry classifications, which contain data on profit-seeking entities as well.

Source: Social Security Administration, Division of Old-Age, Survivor, Disability Insurance Statistics, Earnings and Employment Statistics Branch, Office of Research and Statistics.

TABLE 10-B.—NUMBER OF WORKERS IN NONPROFIT ORGANIZATIONS COVERED BY SOCIAL SECURITY, BY SOCIAL SECURITY INDUSTRY CLASSIFICATION, MARCH 1977

Social Security industry classification	Workers (thousands)
Health services	1,907
Elementary and secondary schools	244
Colleges and universities	422
Educational services, not elsewhere classified	27
Religious organizations	414
Social services	454
Nonprofit membership organizations	143
Miscellaneous professional and related services	72
All other	215
Total	3,898

Note: Data based on tabulations of a sample of wage report items developed within Social Security industry classifications.

Source: Social Security Administration, Division of Old-Age, Survivor, Disability Insurance Statistics, Earnings and Employment Statistics Branch, Office of Research and Statistics.